SASKATCHEWAN FOREST PRODUCTS CORPORATION 1985 ANNUAL REPORT

86-03325/

41ST ANNUAL REPORT

SASKATCHEWAN FOREST PRODUCTS CORPORATION

YEAR ENDED OCTOBER 31, 1985

Regina, Saskatchewan
February 1, 1986

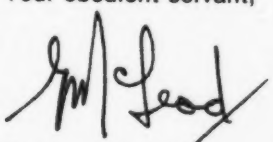
To His Honour,
The Honourable Frederick W. Johnson
Lieutenant Governor of the Province of Saskatchewan

Sir:

I have the honour to submit herewith the annual report of Saskatchewan Forest Products Corporation for the year ended October 31, 1985 including the financial statements therefore, duly certified by the Corporation's auditors and in the form approved by the Treasury Board, all in accordance with The Crown Corporations Act, 1978.

I have the honour to be, Sir,

Your obedient servant,



George McLeod
Minister Responsible,
Saskatchewan Forest
Products Corporation

Board of Directors

Mr. Pat Hill, Chairman of the Board, Saskatoon

Honourable George McLeod, Vice Chairman, Regina

Mr. Harvey Berg, Weekes

Mr. Armand Quessy, Debden

Mr. Alfred Sauder, Carrot River

Mr. Arnold Foss, Pierceland

Mr. Y. Don Elliott, Christopher Lake

Secretary to the Board

Mr. Ronald J. Kruzeniski, Regina

Corporation Officers and Management

Mr. Leslie N. Davies	— General Manager
Mr. Fred Hachey	— Controller
Mr. Dale Vizina	— Woodlands Manager
Mr. Henry A. Peters	— Marketing Manager

Division Management

Mr. Rolland St. Louis	— Manager, Carrot River Sawmill
Mr. Ernie W. Lawrence	— Manager, Big River Sawmill
Mr. Frank Lissner	— Manager, Hudson Bay Plywood
Mr. Eldon Kerbes	— Manager, Wood Treating Plant, Prince Albert

Report of the General Manager

Although the North American demand for lumber products reached record levels during 1985, an oversupply situation held product prices down. Lumber prices fell to the lowest levels in March, peaked in May and continued at lower levels for the balance of the year.

Plywood sales prices were depressed during the first three quarters of the year. Increased construction activity in Central and Eastern Canada combined with increased demand on the export market to create greater total plywood demand which was reflected in considerable price improvement for the last quarter.

Treated wood products sales increased throughout the year, primarily in fence posts and "Outdoor" wood. Price levels improved marginally in all treated wood product lines.

Outlook

Forecasts indicate that U.S. housing starts in 1986 will be slightly below 1985 levels, around 1.65 million. That, coupled with growth in the Renovation/Renewal and "Do-it-yourself" activity would appear to indicate that North American lumber consumption will be close to 1985 levels. It is also forecast that production levels will be similar to 1985, suggesting that lumber selling prices may only improve marginally.

Interest rates, exchange rates, uncertainty of action on countervailing duties by the U.S. and spin off situations from the Pulp Industry may combine to allow price levels to improve slightly.

Plywood prices are expected to continue at the improved levels as continued increases in Canadian home building levels and construction needs are forecast.

Interest rate increases will have a depressing effect on housing construction during the latter part of the year which will in turn reduce product prices.

"Outdoor" wood activities are forecast to improve in volume and marginally in prices in 1986. Greater demand for treated products together with increased marketing activity should allow "Outdoor" wood sales to improve to over 10 million board feet in 1986.

Financial

Improved selling prices and sales by Northern Forest of 2.5 million during 1985 increased sales to $38.8 million from $27.9 million in 1984. In spite of improved sales, the Corporation recorded a loss of $4.3 million. The loss includes amortization and depreciation of $1.2 million and interest expense of $3.1 million.

Total capital expenditures were $1.3 million.

$13.2 million has been borrowed from Crown Management Board against an authorized amount of $20 million. $5.2 million was borrowed during 1985.

Interest expense paid on loans this year was $3.1 million, which represents 8% of total sales.

Report on Operations

Woodlands

Established patterns of logging activity were continued throughout 1985 with minor adjustments to provide for balancing of cuts in all locations.

Power pole production volume objectives continue to be difficult, as S.F.P.C. rely, to a large degree, on the outright purchase of suitable material.

Main haul road construction was very limited during the year, with only winter access road construction maintaining required levels of sawlog and pulpwood production. All Jack Pine cut-overs in the Prince Albert logging operations were treated by anchor chain scarification to encourage natural regeneration.

Incentive awards for S.F.P.C. logging contractors and employees were continued to emphasize the importance of safe working practices to all Woodland contractors and personnel.

Big River Sawmill

Production and productivity improvements attained in 1984 were maintained despite increasingly smaller diameter logs. A packaging line at Planer was near completion at year end. This new line will increase the efficiency of packaging lumber for shipment. Formerly high inventories of both logs and lumber have been reduced to acceptable levels.

Carrot River Sawmill

Production costs at Carrot River were lowered in the year due to increased production, modified work schedules and higher quality sawlogs.

Hudson Bay Plywood Plant

The plant ran on an uninterrupted operation throughout 1985. Activities to upgrade sections of the plant produced significant improvement in performance during the fourth quarter.

High levels of peeler blocks were reduced to acceptable levels during the year.

Treatment Plant

Production and sale of fence posts exceeded budget in 1985. Inventory of post material is now at planned levels.

Manufacture and sale of power poles continues to be constrained by supply. Development of the Cypress Hills area is expected to produce 1,500 poles in 1986 with a potential of supplying 3,000 poles per year. Other sources of poles are also being explored.

Treatment of outdoor wood was less than planned due to low sales volumes. A sales person was hired to market outdoor wood and expectations for 1986 are high.

Northern Forest Operations (a subsidiary)

Effective April 1, 1985 the company acquired the inventories, fixed assets and assumed certain liabilities of five sawmills from the province of Saskatchewan at a net cost of $2,465,218.

Continued emphasis on improved productivity at all operations produced some positive results.

Marketing activities were reinforced in specialty products such as log homes, pallets and reels by placing a sales manager in the field.

Personnel

In 1985, the total number of employees on the active payroll at year end is 470 as compared to 426 in 1984.

Continued emphasis was put on training with both Management and Union personnel attending various seminars and courses during the year.

The Collective Agreement between the Corporation and the International Woodworkers of America expired March 31, 1985. Negotiations continued throughout the year and are not completed at the time of this report.

L.N. Davies
General Manager,
Saskatchewan Forest Products Corporation.

February 1, 1986

AUDITORS' REPORT

To the Members of the Legislative
Assembly of the Province of Saskatchewan

We have examined the consolidated statements of financial position of Saskatchewan Forest Products Corporation as at October 31, 1985 and the consolidated statements of operations and deficit and changes in cash flows for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the corporation as at October 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse

Saskatoon, Saskatchewan
February 10, 1986

Price Waterhouse
Chartered Accountants

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Note Reference	October 31 1985	1984
		(In Thousands)	
ASSETS			
Current assets:			
Cash on deposit		$ 1,244	$ -
Accounts receivable		4,559	4,819
Prepaid expenses		278	167
Inventories	1	10,708	13,183
		16,789	18,169
Investments	1 & 4	117	286
Property, plant and equipment	1 & 5	15,557	15,434
		$32,463	$33,889
LIABILITIES AND PROVINCE'S EQUITY			
Current liabilities:			
Bank indebtedness		$ -	$ 3,088
Accounts payable and accrued		2,305	2,419
Short-term loans	6	14,483	9,283
Due to the Province of Saskatchewan	2	2,726	657
		19,514	15,447
Long-term notes, less current portion	7	14,348	15,548
Province of Saskatchewan's equity:			
Equity advances from Crown Investments Corporation of Saskatchewan	8	20,112	20,112
Deficit		21,511	17,218
		(1,399)	2,894
		$32,463	$33,889

(See accompanying notes)

CONSOLIDATED STATEMENT OF OPERATIONS AND DEFICIT

	Note Reference	Year Ended October 31 1985	1984
		(In Thousands)	
Revenue:			
Sales of forest products		$38,775	$27,954
Expenses:			
Operating costs		37,421	27,763
Selling, general and administrative		1,355	1,207
Depreciation and amortization	1	1,201	1,081
Interest on long-term notes	7	1,732	1,866
Other interest		1,318	491
		43,027	32,408
Loss before the following		4,252	4,454
Share of joint venture loss		21	1
Loss before extraordinary item		4,273	4,455
Extraordinary item	10	20	-
Loss for the year		4,293	4,455
Deficit, beginning of year		17,218	12,763
Deficit, end of year		$21,511	$17,218

(See accompanying notes)

CONSOLIDATED STATEMENT OF CASH FLOWS

	Note Reference	Year Ended October 31 1985	1984
		(In Thousands)	
Cash provided by (used in) operating activities:			
Loss for the year before extraordinary item		$ (4,273)	$ (4,455)
Add charges to operations not requiring a current cash payment —			
Depreciation and amortization	1	1,201	1,081
Share of joint venture loss		21	1
Loss (gain) on sale of property, plant and equipment		29	(24)
		(3,022)	(3,397)
Net change in non-cash working capital balances related to operations	15	9,779	2,490
Cash provided by (used in) operating activities		6,757	(907)
Cash provided by (used in) investment activities:			
Proceeds from sale of property, plant and equipment		4	112
Additions to property, plant and equipment	1 & 5	(1,357)	(1,698)
Decrease in advances to joint venture		128	15
Cash used in investment activities		(1,225)	(1,571)
Cash provided by (used in) financing activities:			
Decrease in other assets			372
Reduction of long-term notes	7	(1,200)	(1,283)
Cash used in financing activities		(1,200)	(911)
Net increase (decrease) in cash during the year		4,332	(3,389)
Cash on deposit (bank indebtedness), beginning of year		(3,088)	301
Cash on deposit (bank indebtedness), end of year		$ 1,244	$ (3,088)

(See accompanying notes)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
OCTOBER 31, 1985

1. Summary of accounting policies:

This summary of significant accounting policies is a description of the accounting methods and practices that have been used in the preparation of these consolidated financial statements.

Consolidation principles —

These consolidated financial statements include the accounts of the company's wholly-owned subsidiary, Northern Forest Operations Ltd.

Inventories —

Inventories of logs and mill supplies are valued at the lower of cost and replacement cost. Inventories of lumber, plywood and treated products are valued at the lower of average cost and net realizable value. Average cost includes appropriate production overheads.

Investments —

The corporation follows the equity method of accounting for its investment in a joint venture. The corporation's investment in co-operatives is recorded at cost with dividends being reflected in earnings when received.

Property, plant and equipment —

The costs of maintenance, repairs and minor renewals or replacements are charged to operations as they arise. The cost of major replacements, extensions and improvements are capitalized in the property, plant and equipment accounts. Government grants received in connection with the construction or expansion of production facilities are credited to the cost of such assets. On retirement or disposition of property, plant and equipment, the costs thereof and the related accumulated depreciation are eliminated from the accounts and any gains or losses are reflected in the statement of operations.

Property, plant and equipment are depreciated over their estimated useful lives primarily on the diminishing-balance basis at the following rates:

Buildings	5 - 10%
Machinery and equipment	6.7 - 10%
Vehicles	15%
Site improvements	4%
Office equipment	10%
Roads	10%

2. Due to the Province of Saskatchewan:

	October 31 1985	1984
	(In Thousands)	
Net assets purchased —		
Northern Forest Operations Ltd. (Note 3):		
Inventories	$ 1,886	$ -
Fixed assets	741	-
Current liabilities	(162)	-
Advances	261	657
	$ 2,726	$ 657

3. Operations acquisition:

Effective March 31, 1985 the company's wholly-owned subsidiary, Northern Forest Operations Ltd., acquired the inventories, fixed assets and assumed certain liabilities of five sawmills from the Province of Saskatchewan. Under the terms of the purchase agreement, the Province of Saskatchewan agreed to pay Northern Forest Operations Ltd. a subsidy equal to the amount of any losses incurred arising from the operations of the purchased property from April 1, 1985 to October 31, 1985.

4. Investments:

	October 31 1985	1984
	(In Thousands)	
Investment in and advances to joint venture	$ 112	$ 281
Investment in co-operatives	5	5
	$ 117	$ 286

The corporation has a 51% interest in Western Overlay Industries, a joint venture. During 1985, Western Overlay Industries' fixed assets were sold for total proceeds of $246,600. The joint venture for the year ended October 31, 1985 incurred a loss of $234,000 which included interest payable to the corporation of $194,000. The corporation's current carrying value of its investment has been written-down to reflect the underlying net asset value (see Note 10).

5. Property, plant and equipment:

	October 31 1985	1984
	(In Thousands)	
Land	$ 647	$ 590
Building and site improvements	6,450	5,868
Roads and spur tracks	3,429	3,370
Machinery and equipment	12,770	12,196
	23,296	22,024
Less: Accumulated depreciation	7,739	6,590
	$15,557	$15,434

6. Short-term loans:

	October 31 1985	1984
	(In Thousands)	
Bank loans	$ -	$ 6,500
Crown Investments Corporation of Saskatchewan	13,200	1,500
Current portion of long-term notes	1,283	1,283
	$14,483	$ 9,283

7. Long-term notes:

	October 31 1985	1984
	(In Thousands)	
Crown Investments Corporation of Saskatchewan 10% promissory note repayment in annual instalments of $83,400. Interest is only payable in years in which the corporation records net earnings.	$ 1,084	$ 1,084
Crown Investments Corporation of Saskatchewan promissory note, see below.	$14,547	$15,747
	15,631	16,831
Less: Portion due within one year classified as current	1,283	1,283
	14,348	15,548

As at October 30, 1982 the corporation had borrowed $15.4 million from Crown Investments Corporation through a series of short-term loans. On October 31, 1982 these short-term loans, together with accrued interest thereon of $1,647,000, were converted to a 15 year long-term loan. Interest on this loan is negotiated November 1 annually. The interest rate over the past year was 10% (1984 - 11%). Principal repayments will be $1,200,000 on each October 31 until maturity with the final payment being $1,347,000. Principal may be repaid prior to maturity without penalty. Interest is due annually.

8. The Province of Saskatchewan's equity:

The Province of Saskatchewan's equity in the corporation is made up of equity advances by the Crown Investments Corporation of Saskatchewan to the corporation since its inception, less amounts repaid or forgiven. These advances are repayable at the discretion of the Crown Investments Corporation of Saskatchewan and do not bear interest. The deficit represents accumulative profits and losses of the corporation since the date of the reorganization on November 1, 1977.

9. Status of Saskatchewan Forest Products Corporation:

The corporation was established by Order-in-Council 1899 of 1949 and continues under the provisions of The Crown Corporations Act. These financial statements will be consolidated in the accounts of the Crown Investments Corporation of Saskatchewan.

10. Extraordinary item:

During the year the corporation wrote down its investment in Western Overlay Industries to reflect the underlying net asset value of $112,000.

11. Related party transactions:

Included in these consolidated financial statements are income and expense amounts resulting from routine operating transactions conducted at prevailing market prices with various Saskatchewan Crown controlled departments, agencies and corporations with which the corporation is related.

Account balances resulting from these transactions are included in the consolidated statement of financial position and are settled on normal trade terms.

Other amounts due to related parties and the terms of settlement are described separately in the consolidated financial statements and the notes thereto.

12. Remuneration:

The corporation's directors received remuneration of $6,000 (1984 - $6,000) during the fiscal year. The senior officers received in aggregate remuneration of $222,000 for 1985 (1984 - $229,000).

13. Contingencies:

The corporation, being the defendant to several unresolved statements of claim, has provided for them in its accounts in accordance with advice received from its legal counsel. Any difference which may arise, between amounts provided and amounts experienced, will be accounted for in the period in which the claims are resolved.

14. Comparative figures:

Certain prior year's figures have been reclassified for comparative purposes.

15. Statement of cash flows:

The net change in non-cash working capital balances related to operations is comprised of the following:

Cash provided by (used in) operating activities:	October 31 1985 (In Thousands)	1984
Decrease (increase) in accounts receivable	$ 260	$ (334)
Decrease (increase) in prepaid expenses	(111)	530
Decrease (increase) in inventories	2,475	(4,499)
(Decrease) in accounts payable and accrued	(114)	(363)
Increase in short-term loans	5,200	6,499
Increase in due to Province of Saskatchewan	2,069	657
Net change in non-cash working capital balances related to operations	$ 9,779	$ 2,490